



**International Bancshares
Corporation**

July 26, 2017

Via email regs.comments@federalreserve.gov

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Re: Docket No. R-1564 – 12 CFR Part 229 RIN 7100 AE 78 (Reg. CC) - Availability of Funds and Collection of Checks; Board of Governors of the Federal Reserve System ("Board")

Ladies and Gentlemen:

The following comments are submitted on behalf of International Bancshares Corporation ("IBC"), a multi-bank financial holding company headquartered in Laredo, Texas. IBC holds five state nonmember banks serving Texas and Oklahoma. With approximately \$12 billion in total consolidated assets, IBC is one of the largest independent commercial bank holding companies headquartered in Texas. IBC is a publicly-traded holding company. We appreciate the opportunity to comment on the Board's proposal.

On May 31, 2017, the Board proposed amending Regulation CC to address situations where there is a dispute as to whether a check has been altered or is a forgery, and the original paper check is not available for inspection. The proposed rule would adopt a presumption of alteration for any dispute over whether the dollar amount or the payee on a substitute check or electronic check has been altered or whether the substitute check or electronic check is derived from an original check that is a forgery. This rule is intended to provide clarity as to the burden of proof in these situations.

Under the proposed rule, the presumption of alteration may be overcome by a preponderance of evidence that the substitute check or electronic check accurately represents the dollar amount and payee as authorized by the drawer, or that the substitute check or electronic check is derived from an original check that is a forgery. The proposed rule would also state that the presumption of alteration shall cease to apply if the original check is made available for examination by all parties involved in the dispute.

The Board is also proposing accompanying commentary provisions to explain the operation of the rule, including clarification that the presumption does not alter the process by which a bank may seek to make a claim against another bank on a check that the bank alleges to be altered.

IBC Comments

In general, under Section 4-401 of the Uniform Commercial Code ("U.C.C."), the paying bank may charge the drawer's account only for checks that are properly payable. Neither altered checks nor forged checks are properly payable. In the case of an altered check under the U.C.C., the banks that received the check during forward collection, including the paying bank, have warranty claims against the banks that transferred the check (e.g., a collecting bank or the depository bank). In the case of a forged check, however, the U.C.C. places the responsibility on the paying bank for identifying the forgery.¹

The provisions of U.C.C. Section 4-401 reflect the long-standing rule set forth in *Price v. Neal*² that the paying bank must bear the loss when a check it pays is not properly payable by virtue of the fact that the drawer did not authorize the item.³ The *Price v. Neal* rule reflects the assumption that the paying bank, rather than the depository bank, is in the best position to judge whether the drawer's signature on a check is the authorized signature of the account-holder. By contrast, the depository bank is arguably in a better position than the paying bank to inspect the check at the time of deposit and detect an alteration to the face of the check, to determine that the amount of the check is unusual for the depository bank's customer, or to otherwise take responsibility for the items it accepts for deposit. Therefore, the depository bank typically bears the loss related to an altered check, whereas the paying bank bears the loss related to a forged check.

Regulation CC does not currently address whether a check should be presumed to be altered or forged in cases of doubt. For example, an unauthorized payee name could result from an alteration of the original check that the drawer issued, or from the creation of a forged check bearing the unauthorized payee name and an unauthorized/forged drawer's signature. Courts have reached opposite conclusions as to whether a paid, but fraudulent, check should be presumed to be altered or forged in the absence of evidence (such as the original check).⁴ Since the time of these decisions, the check collection system has become overwhelmingly electronic, and the number of instances in which the original paper check is available for inspection in such cases will be quite low.⁵ Unlike the 2006 court cases, where the paying bank received and destroyed the original check, in today's check environment the original check is typically truncated by the depository bank or a collecting bank before it reaches the paying bank.

¹ The presenting bank warrants to the paying bank only that it has no knowledge of an unauthorized drawer's signature. See U.C.C. 3-417 and 4-208.

² 97 Eng Reg 871 (K.B. 1762).

³ *Id.*

⁴ See, e.g., *Chevy Chase Bank v. Wachovia Bank, NA.*, 208 Fed. App'x. 232, 235 (4th Cir. 2006) and *Wachovia Bank, N.A. v. Foster Bancshares, Inc.*, 457 F.3d 619 (7th Cir. 2006).

⁵ For example, according to the preamble of the Board's proposal, the Board states that by the beginning of 2017 the Federal Reserve Banks received over 99.99 percent of checks electronically from 99.06 percent of routing numbers and presented over 99.99 percent of checks electronically to over 99.76 percent of routing numbers. As of the same time, the Federal Reserve Banks received 99.63 percent of returned checks electronically from over 99.37 percent of routing numbers and delivered 99.41 percent of returned checks electronically to 92.84 percent of routing numbers.

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For a variety of reasons, IBC supports a rule within Regulation CC that creates a presumption of alteration in the event that there is insufficient evidence to determine whether or not a particular check image on a substitute or electronic check was altered or is a counterfeit item. IBC believes that the substance of the U.C.C.'s loss-allocation framework for altered and forged checks, under which the depository bank generally bears the loss for altered checks and the paying bank generally bears the loss for forged checks, continues to be appropriate in the current check-processing environment. IBC also believes that there is a value to having a predictable and uniform national rule for the resolution of this type of dispute. A uniform rule is of particular value since there are different court decisions governing how this type of dispute is resolved under the law.

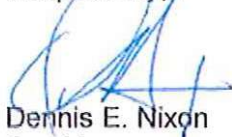
A presumption of alteration (imposing the risk of loss on the depository bank as described above) is appropriate in today's virtually all-electronic environment. In today's environment the vast majority of checks are truncated by the depository banks or their customers, the depository bank has the option of retaining the original check, and if the depository bank presents a substitute check, the paying bank does not have the right to demand presentment of the original check.

Also, by way of analogy, the ECCHO Rules⁶ establish a presumption of alteration in the context of exchanges that are governed by the ECCHO Rules. This ECCHO Rule was adopted after consideration of the options for the evidentiary presumption, and the ECCHO Rule reflects the view of the ECCHO members that in a situation where there is a lack of evidence, it is more likely than not that the item is in fact an altered item. For example, in the context of a corporate client with a positive pay service in place, a counterfeit item is not likely to be paid since the dollar amounts will not match, whereas an altered item will be paid when the dollar amounts and check number match, but the proceeds are taken by an altered fraudulent payee.

For the foregoing reasons, IBC supports a rule within Regulation CC that creates a presumption of alteration in the event that there is insufficient evidence to determine whether or not a particular check image on a substitute or electronic check was altered or is a counterfeit item.

Thank you for your consideration.

Respectfully,



Dennis E. Nixon
President
International Bancshares Corporation

⁶ ECCHO Rules are clearinghouse rules under the U.C.C.. ECCHO is a check clearinghouse whose membership consists solely of U.S. depository institutions. As a national clearinghouse, ECCHO seeks to facilitate the exchange of electronic check transactions between depository institutions of all sizes throughout the United States.